

2011 Credit Facilities

On November 8, 2011, we entered into a credit agreement establishing a credit facility that included: (1) a \$600 million senior secured term loan facility, or 2011 Term Facility; and (2) a \$100 million senior secured revolving credit facility, or 2011 Revolving Facility, and together with the 2011 Term Facility, the 2011 Credit Facilities. The maturity date of the 2011 Revolving Facility was November 8, 2016, and the maturity date of the 2011 Term Facility was November 8, 2018. The entire \$600 million 2011 Term Facility was borrowed on November 8, 2011, and used to fund a portion of the acquisition of TARGUSinfo and to pay costs, fees and expenses incurred in connection with the acquisition. We did not borrow any amounts under the 2011 Revolving Facility in the years ended December 31, 2011 and 2012. As of December 31, 2012, available borrowings under the 2011 Revolving Facility were reduced by outstanding letters of credit totaling \$7.8 million. On January 22, 2013, we refinanced this credit facility. See Subsequent Event — Debt Refinancing below.

Principal payments under the 2011 Term Facility of \$1.5 million were due on the last day of the quarter starting on December 31, 2011 and ending on September 30, 2018. The remaining 2011 Term Facility principal balance of \$558.0 million was due in full on November 8, 2018, subject to early mandatory prepayments. The loans outstanding under the credit facility bore interest, at our option, either: (1) at the base rate, which was defined as the highest of (a) the federal funds rate plus 0.50%, (b) the interest rate published by the Wall Street Journal as the “U.S. Prime Rate” and (c) the adjusted LIBOR rate for a one-month interest period beginning on such day plus 1.00%; *provided* that the base rate for loans under the 2011 Term Facility was deemed to be not less than 2.25% per annum or (2) at the LIBOR rate plus, in each case, an applicable margin. The applicable margin was (1) in respect of the 2011 Term Facility, 2.75% per annum for borrowings based on the base rate and 3.75% per annum for borrowings based on the LIBOR rate, and (2) in respect of the 2011 Revolving Facility, 2.50% per annum for borrowings based on the base rate and 3.50% per annum borrowings based on the LIBOR rate. The accrued interest under the 2011 Term Facility was payable quarterly beginning on February 8, 2012. As of December 31, 2012, the annual interest rate on the 2011 Term Facility was 5%. The accrued interest under the 2011 Revolving Facility was due on the last day of the quarter starting on December 31, 2011.

The 2011 Term Facility had a 1% prepayment fee in the event it was refinanced within the first year of issuance. The 2011 Credit Facilities provided for mandatory prepayments with the net cash proceeds of certain debt issuances, equity issuances, insurance receipts, dispositions and excess cash flows. Mandatory prepayments attributable to excess cash flows were based on our leverage ratio and determined at the end of each fiscal year, beginning with the year ended December 31, 2012. A leverage ratio of 1.5x or higher would have triggered mandatory prepayments of 25% or 50% of excess cash flow.

As of December 31, 2012, our outstanding principal balance under the 2011 Term Facility was \$592.5 million and accrued interest was zero. See Subsequent Event — Debt Refinancing below.

Subsequent Event — Debt Refinancing

On January 22, 2013, we entered into a credit facility that provided for a \$325 million senior secured term loan facility, or 2013 Term Facility, and a \$200 million senior secured revolving credit facility, or the 2013 Revolving Facility, and together with the 2013 Term Facility, the 2013 Credit Facilities. In addition, we closed an offering of \$300 million aggregate principal amount of senior notes, or Notes. We used the proceeds received from the 2013 Term Facility and Notes to repay our outstanding principal borrowings of \$592.5 million under the 2011 Term Facility. Our 2011 Credit Facilities were terminated in connection with this refinancing event.

For further discussion of this debt refinancing, see Note 9 to our Consolidated Financial Statements in Item 8 of Part II of this report.

Discussion of Cash Flows

2012 compared to 2011

Cash flows from operations

Net cash provided by operating activities for the year ended December 31, 2012 was \$303.6 million, as compared to \$226.4 million for the year ended December 31, 2011. This \$77.2 million increase in net cash provided by operating activities was the result of a decrease in net income of \$4.7 million, an increase in non-cash adjustments of \$21.7 million, and an increase in net changes in operating assets and liabilities of \$60.2 million.

Net income decreased \$4.7 million due in part to a decrease of \$37.2 million in income from discontinued operations, net of tax, recorded in 2011 and for which there was no corresponding amount in 2012. The income from discontinued operations, net of tax, recorded in 2011 included a \$42.7 million worthless stock deduction for the common stock of Neustar NGM Services, Inc. This decrease of \$37.2 million was partially offset by an increase of \$27.9 million in interest and other expense related to our 2011 Credit Facilities.

Non-cash adjustments increased \$21.7 million due in part to an increase of \$46.1 million in depreciation and amortization expense, an increase of \$3.3 million in the amortization of our deferred financing costs and original debt discount from our 2011 Credit Facilities, and an increase of \$1.5 million in our provision for doubtful account. This increase in non-cash adjustments was partially offset by a decrease of \$21.0 million in deferred income taxes, a decrease of \$4.5 million in excess tax benefits from stock option exercises, a decrease of \$2.4 million in the net amortization of investment premium and a \$1.9 million in loss on sale recorded in the first quarter of 2011 attributable to the sale of certain assets liabilities of our Converged Messaging Services business.

Net changes in operating assets and liabilities increased \$60.2 million primarily due to a decrease of \$59.1 million in income taxes receivable, primarily the result of the tax benefit we recorded in the first quarter of 2011 in connection with a worthless stock loss deduction, a decrease of \$20.4 million in prepaid expenses and other current assets, a net decrease of \$7.7 million in notes receivable, and an increase of \$6.6 million in deferred revenue. These increases in net changes in operating assets and liabilities were partially offset by a net change of \$30.2 million attributable to net increases in accounts and unbilled receivables, a net change of \$9.1 million attributable to increases in accounts payable and accrued expenses, and a net change of \$3.3 million attributable to a decrease in accrued restructuring reserve.

Cash flows from investing

Net cash used in investing activities for the year ended December 31, 2012 was \$43.6 million, as compared to \$706.4 million for the year ended December 31, 2011. This \$662.8 million decrease in net cash used in investing activities was primarily due to a decrease of \$696.3 million in cash used for acquisitions and a decrease of \$79.7 million in investment purchases. These decreases in net cash used in investing activities were partially offset by a decrease of \$105.8 million in cash received from the sale and maturities of investments and an increase of \$7.3 million in cash used to purchase property and equipment.

Cash flows from financing

Net cash used in financing activities was \$41.9 million for the year ended December 31, 2012, as compared to cash provided by financing activities of \$270.9 million for year ended December 31, 2011. This \$312.8 million increase in net cash used in financing activities was primarily due to a decrease of \$591.0 million in cash received under our 2011 Credit Facilities, an increase of \$8.6 million in cash used for the repurchase of restricted stock awards attributable to participants' electing to use stock to satisfy their tax withholdings, and an increase of \$4.5 million in cash used for principal repayments on our 2011 Credit Facilities. These increases in cash used in financing activities were partially offset by a decrease of \$226.3 million in cash used to repurchase shares of our Class A common stock under our share repurchase programs, a decrease of \$20.4 million in debt issuance costs

attributed to our 2011 Credit Facilities, an increase of \$19.8 million in proceeds from the exercise of stock options, a net change of \$16.6 million attributable to a decrease in restricted cash, an increase of \$4.5 million in excess tax benefits from stock-based compensation, and a reduction of \$3.7 million in cash used in principal repayments on capital lease obligations.

2011 compared to 2010

Cash flows from operations

Net cash provided by operating activities for the year ended December 31, 2011 was \$226.4 million, as compared to \$144.8 million for the year ended December 31, 2010. This \$81.6 million increase in net cash provided by operating activities was the result of an increase in net income of \$54.6 million, an increase in non-cash adjustments of \$29.4 million, and a decrease in net changes in operating assets and liabilities of \$2.4 million.

Net income increased \$54.6 million primarily due to a change of \$55.1 million in the income tax benefit from discontinued operations. In the first quarter of 2011, we recorded a tax benefit of \$42.7 million related to a worthless stock loss deduction for the common stock of NGM Services.

Non-cash adjustments increased \$29.4 million due to an increase of \$19.5 million in deferred income taxes, an increase of \$9.8 million in stock-based compensation, an increase of \$6.7 million in depreciation and amortization expense, an increase of \$3.0 million in amortization of investment premiums, and a \$1.9 million loss-on-sale attributable to the sale of certain assets and liabilities of our Converged Messaging Services business in the first quarter of 2011. These increases in non-cash adjustments were partially offset by a decrease of \$8.5 million attributed to an impairment of long-lived assets of our Converged Messaging Services business recorded in 2010, and a decrease of \$2.9 million in excess tax benefits from stock option exercises.

Net changes in operating assets and liabilities decreased \$2.4 million primarily due to an increase of \$18.8 million in income taxes receivable, primarily the result of the tax benefit we recorded in the first quarter of 2011 in connection with a deduction for the loss on worthless stock, a decrease of \$10.0 million in other liabilities, and an increase of \$7.7 million in prepaid expenses and other current assets. In addition, deferred costs increased \$3.7 million and notes receivable increased \$3.4 million. These decreases in net changes in operating assets and liabilities were partially offset by a net change of \$25.2 million attributable to net increases in accounts payable and accrued expenses during 2011 as compared to decreases in 2010, and a net change of \$20.2 million attributable to net decreases in accounts and unbilled receivables during 2011 as compared to increases in 2010.

Cash flows from investing

Net cash used in investing activities for the year ended December 31, 2011 was \$706.4 million, as compared to \$72.8 million for the year ended December 31, 2010. This \$633.6 million increase in net cash used in investing activities was primarily due to an increase of \$673.9 million in cash used for acquisitions, an increase of \$30.5 million in investment purchases, and an increase \$7.7 million in cash used for purchases of property and equipment. These increases in net cash used in investing activities were partially offset by the increase of \$78.4 million in cash received from the sales of investments.

Cash flows from financing

Net cash provided by financing activities was \$270.9 million for the year ended December 31, 2011, as compared to net cash used in financing activities of \$45.0 million for the year ended December 31, 2010. This \$315.9 million increase in net cash provided by financing activities was primarily the result of net proceeds of \$591.0 million from our 2011 Credit Facilities, and an increase of \$31.5 million in proceeds from the exercise of

stock options and a reduction of \$5.0 million in cash used in principal repayments on capital lease obligations. These increases in cash provided by financing activities were partially offset by an increase of \$283.9 million in cash used to repurchase shares of our Class A common stock under our share repurchase programs, an increase of \$20.4 million in debt issuance costs, and a net increase of \$8.8 million in restricted cash primarily used to collateralize our outstanding letters of credit.

Contractual Obligations

Our principal commitments consist of obligations under our 2013 Notes, 2013 Credit Facilities, leases for office space, computer equipment and furniture and fixtures, and deferred tax liabilities. The following table summarizes our long-term contractual obligations as December 31, 2012 for our capital lease obligations, operating lease obligations, and deferred tax liabilities, and as of January 22, 2013 for our 2013 Term Facility and Notes:

	Payments Due by Period				
	Total	Less Than 1 Year	2-3 Years	4-5 Years	More Than 5 Years
			(in thousands)		
Capital lease obligations	\$ 2,639	\$ 1,794	\$ 845	\$ —	\$ —
Operating lease obligations	83,620	13,074	23,234	19,367	27,945
2013 Term Facility ⁽¹⁾	352,866	13,659	27,556	26,978	284,673
Notes ⁽¹⁾	435,000	12,750	27,000	27,000	368,250
Deferred tax liabilities	114,130	25,102	49,337	36,756	2,935
Total	<u>\$988,255</u>	<u>\$66,379</u>	<u>\$127,972</u>	<u>\$110,101</u>	<u>\$683,803</u>

- (1) On January 22, 2013, we refinanced our 2011 Term Facility with the Notes and the 2013 Term Facility under the 2013 Credit Facilities. Interest expense related to the Notes has been calculated using a fixed 4.5% interest rate. Interest expense related to the 2013 Term Facility has been calculated using a rate of 1.80% as of January 22, 2013.

Some of our commercial commitments are secured by standby letters of credit. The following is a summary of our commercial commitments secured by standby letters of credit by commitment date as of December 31, 2012:

	Total	Less Than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
			(in thousands)		
Standby letters of credit	<u>\$9,910</u>	<u>\$1,800</u>	<u>\$7,780</u>	<u>\$—</u>	<u>\$330</u>

The amounts presented in the tables above may not necessarily reflect our actual future cash funding requirements because the actual timing of the future payments made may vary from the stated contractual obligation. Due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2012, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, we have not included \$4.4 million of unrecognized tax benefits and interest thereon, in the contractual obligations table above. See Note 13 to the consolidated financial statements in Item 8 of Part II of this report for a discussion on income taxes.

Effect of Inflation

Inflation generally affects us by increasing our cost of labor and equipment. We do not believe that inflation had any material effect on our results of operations during the years ended December 31, 2010, 2011 and 2012.

Recent Accounting Pronouncements

See Note 2 to our Consolidated Financial Statements in Item 8 of Part II of this report for a discussion of the effects of recent accounting pronouncements.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of December 31, 2011 and 2012.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to a variety of market risks, including changes in interest rates affecting the return on our 2011 Term Facility, investments, and foreign currency fluctuations.

Borrowings outstanding under our 2011 Term Facility bore interest, at our option, either: (1) at the base rate, which was defined as the highest of (a) the federal funds rate plus 0.50%, (b) the interest rate published by the Wall Street Journal as the "U.S. Prime Rate" and (c) the adjusted LIBOR rate for a one-month interest period beginning on such day plus 1.00%; provided that the base rate for loans under the 2011 Term Facility was deemed to be not less than 2.25% per annum or (2) at the LIBOR rate plus, in each case, an applicable margin. The applicable margin was (1) in respect of the 2011 Term Facility, 2.75% per annum for borrowings based on the base rate and 3.75% per annum for borrowings based on the LIBOR rate, and (2) in respect of the 2011 Revolving Facility, 2.50% per annum for borrowings based on the base rate and 3.50% per annum borrowings based on the LIBOR rate. As of December 31, 2012, the LIBOR rate on our 2011 Term Facility was below the applicable margin, or floor, and a hypothetical increase or decrease of 10% in the LIBOR rate would not have impacted our interest rate.

Exposure to market rate risk for changes in interest rates affects the value of our investment portfolio. We have not used derivative financial instruments to hedge against such risk in our investment portfolio. We invest in securities of highly-rated issuers and follow investment policies limiting, among other things, the amount of credit exposure to any one issuer. We seek to limit default risk by purchasing only investment-grade securities. We do not actively manage the risk of interest rate fluctuations on our short-term investments; however, our exposure to this risk is mitigated by the relatively short-term nature of these investments. Based on a hypothetical 10% adverse movement in interest rates, the impact on our interest income for our short-term investments for the year ended December 31, 2012 would have been insignificant.

We have accounts on our foreign subsidiaries' ledgers which are maintained in the respective subsidiary's local foreign currency and remeasured into the United States dollar. As a result, we are exposed to movements in the exchange rates of various currencies against the United States dollar and against the currencies of other countries in which we sell services. As of December 31, 2012, our assets and liabilities related to non-dollar denominated currencies were primarily related to intercompany payables and receivables. An increase or decrease of 10% in foreign exchange rate would not have a material impact on our financial position.

Because our sales and expense are primarily denominated in local currency, the impact of foreign currency fluctuations on sales and expenses has not been material, and we do not employ measures intended to manage foreign exchange rate risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
NeuStar, Inc.

We have audited the accompanying consolidated balance sheets of NeuStar, Inc. as of December 31, 2011 and 2012, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2012. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NeuStar, Inc. at December 31, 2011 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2012, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), NeuStar, Inc.'s internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 28, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia
February 28, 2013

NEUSTAR, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31,	
	2011	2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 122,237	\$ 340,255
Restricted cash	10,251	2,543
Short-term investments	10,545	3,666
Accounts receivable, net of allowance for doubtful accounts of \$1,942 and \$2,161, respectively	106,274	131,805
Unbilled receivables	5,551	6,372
Notes receivable	2,786	2,740
Prepaid expenses and other current assets	30,420	17,707
Deferred costs	8,174	7,379
Income taxes receivable	37,874	6,596
Deferred tax assets	7,728	6,693
Total current assets	341,840	525,756
Long-term investments	2,506	—
Property and equipment, net	100,102	118,513
Goodwill	572,178	572,178
Intangible assets, net	338,768	288,487
Notes receivable, long-term	3,748	1,008
Deferred costs, long-term	701	702
Other assets, long-term	22,767	20,080
Total assets	<u>\$1,382,610</u>	<u>\$1,526,724</u>

See accompanying notes.

NEUSTAR, INC.

CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31,	
	2011	2012
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 7,385	\$ 9,269
Accrued expenses	79,334	85,424
Deferred revenue	41,080	49,070
Note payable	4,856	8,125
Capital lease obligations	3,065	1,686
Accrued restructuring reserve	4,361	372
Other liabilities	5,317	3,484
Total current liabilities	145,398	157,430
Deferred revenue, long-term	10,363	9,922
Note payable, long-term	584,809	576,688
Capital lease obligations, long-term	1,918	817
Deferred tax liability, long-term	120,948	114,130
Other liabilities, long-term	16,540	21,129
Total liabilities	879,976	880,116
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, \$0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2011 and 2012	—	—
Class A common stock, par value \$0.001; 200,000,000 shares authorized; 82,959,411 and 85,958,791 shares issued; and 66,151,479 and 66,171,702 outstanding at December 31, 2011 and 2012, respectively	83	86
Class B common stock, par value \$0.001; 100,000,000 shares authorized; 3,082 and 3,082 shares issued and outstanding at December 31, 2011 and 2012, respectively	—	—
Additional paid-in capital	436,598	532,743
Treasury stock, 16,807,932 and 19,787,089 shares at December 31, 2011 and 2012, respectively, at cost	(495,790)	(604,042)
Accumulated other comprehensive loss	(758)	(767)
Retained earnings	562,501	718,588
Total stockholders' equity	502,634	646,608
Total liabilities and stockholders' equity	<u>\$1,382,610</u>	<u>\$1,526,724</u>

See accompanying notes.

NEUSTAR, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2010	2011	2012
Revenue:			
Carrier Services	\$391,762	\$447,894	\$502,085
Enterprise Services	129,104	151,390	170,440
Information Services	—	21,171	158,863
Total revenue	520,866	620,455	831,388
Operating expense:			
Cost of revenue (excluding depreciation and amortization shown separately below)	111,282	137,992	185,965
Sales and marketing	86,363	109,855	163,729
Research and development	13,780	17,509	29,794
General and administrative	65,496	96,317	81,797
Depreciation and amortization	32,861	46,209	92,955
Restructuring charges	5,361	3,549	489
	315,143	411,431	554,729
Income from operations	205,723	209,024	276,659
Other (expense) income:			
Interest and other expense	(6,995)	(6,279)	(34,155)
Interest and other income	7,582	1,966	596
Income from continuing operations before income taxes	206,310	204,711	243,100
Provision for income taxes, continuing operations	82,282	81,137	87,013
Income from continuing operations	124,028	123,574	156,087
(Loss) income from discontinued operations, net of tax	(17,819)	37,249	—
Net income	\$106,209	\$160,823	\$156,087
Basic net income (loss) per common share:			
Continuing operations	\$ 1.66	\$ 1.69	\$ 2.34
Discontinued operations	(0.24)	0.51	—
Basic net income per common share	\$ 1.42	\$ 2.20	\$ 2.34
Diluted net income (loss) per common share:			
Continuing operations	\$ 1.63	\$ 1.66	\$ 2.30
Discontinued operations	(0.23)	0.50	—
Diluted net income per common share	\$ 1.40	\$ 2.16	\$ 2.30
Weighted average common shares outstanding:			
Basic	74,555	72,974	66,737
Diluted	76,065	74,496	67,956

See accompanying notes.

NEUSTAR, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Year Ended December 31,		
	2010	2011	2012
Net income	\$106,209	\$160,823	\$156,087
Other comprehensive income (loss), net of tax:			
Available for sale investments, net of tax:			
Change in net unrealized gains, net of tax of \$140, \$(3) and \$86, respectively	277	(119)	192
Reclassification for gains included in net income, net of tax of \$0, \$217 and \$0, respectively	—	(332)	—
Net change in unrealized gains on investments, net of tax	277	(451)	192
Foreign currency translation adjustment, net of tax:			
Change in foreign currency translation adjustment, net of tax of \$109, \$(261) and \$85, respectively	42	305	(201)
Reclassification adjustment included in net income, net of tax of \$0, \$307 and \$0, respectively	—	(468)	—
Foreign currency translation adjustment, net of tax	42	(163)	(201)
Other comprehensive income (loss), net of tax	319	(614)	(9)
Comprehensive income	<u>\$106,528</u>	<u>\$160,209</u>	<u>\$156,078</u>

See accompanying notes.

NEUSTAR, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)

	Class A Common Stock		Class B Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Shares	Amount					
Balance at December 31, 2009	79,425	\$ 79	3	\$—	\$338,109	\$(128,757)	\$(463)	\$295,469	\$ 504,437
Common stock options exercised	596	1	—	—	7,765	—	—	—	7,766
Stock-based compensation expense	—	—	—	—	18,252	—	—	—	18,252
Restricted stock granted, net	274	—	—	—	—	—	—	—	—
Common stock repurchase	—	—	—	—	—	(40,400)	—	—	(40,400)
Common stock received for tax withholding	—	—	—	—	—	(691)	—	—	(691)
Net excess tax benefit from stock option exercises	—	—	—	—	220	—	—	—	220
Net income	—	—	—	—	—	—	—	106,209	106,209
Other comprehensive income	—	—	—	—	—	—	319	—	319
Balance at December 31, 2010	80,295	80	3	—	364,346	(169,848)	(144)	401,678	596,112
Common stock options exercised	2,340	3	—	—	39,275	—	—	—	39,278
Stock-based compensation expense	—	—	—	—	28,088	—	—	—	28,088
Equity awards assumed in TARGUSinfo acquisition	—	—	—	—	677	—	—	—	677
Restricted stock granted, net	324	—	—	—	—	—	—	—	—
Common stock repurchase	—	—	—	—	—	(324,301)	—	—	(324,301)
Common stock received for tax withholding	—	—	—	—	—	(1,641)	—	—	(1,641)
Net excess tax benefit from stock option exercises	—	—	—	—	4,212	—	—	—	4,212
Net income	—	—	—	—	—	—	—	160,823	160,823
Other comprehensive income	—	—	—	—	—	—	(614)	—	(614)
Balance at December 31, 2011	82,959	83	3	—	436,598	(495,790)	(758)	562,501	502,634
Common stock options exercised	2,500	3	—	—	59,053	—	—	—	59,056
Stock-based compensation expense	—	—	—	—	28,058	—	—	—	28,058
Restricted stock granted, net	500	—	—	—	—	—	—	—	—
Common stock repurchase	—	—	—	—	—	(98,040)	—	—	(98,040)
Common stock received for tax withholding	—	—	—	—	—	(10,212)	—	—	(10,212)
Net excess tax benefit from stock option exercises	—	—	—	—	9,034	—	—	—	9,034
Net income	—	—	—	—	—	—	—	156,087	156,087
Other comprehensive income	—	—	—	—	—	—	(9)	—	(9)
Balance at December 31, 2012	85,959	\$ 86	3	\$—	\$532,743	\$(604,042)	\$(767)	\$718,588	\$ 646,608

See accompanying notes.

NEUSTAR, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2010	2011	2012
Operating activities:			
Net income	\$106,209	\$ 160,823	\$156,087
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	40,167	46,837	92,955
Stock-based compensation	18,252	28,088	28,058
Amortization of deferred financing costs and original issue discount on debt	170	764	4,062
Excess tax benefits from stock option exercises	(1,613)	(4,541)	(9,041)
Deferred income taxes	(4,430)	15,025	(5,958)
Impairment of long-lived assets	8,495	—	—
Provision for doubtful accounts	2,600	2,596	4,086
Gains on available-for-sale investments and trading securities	(7,007)	(701)	—
Loss on auction rate securities rights	6,892	—	—
Amortization of bond premium	12	2,975	546
Loss on asset sale	—	1,933	—
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	(17,515)	(3,624)	(30,874)
Unbilled receivables	(4,202)	2,111	(821)
Notes receivable	(1,590)	(4,944)	2,786
Prepaid expenses and other current assets	(640)	(8,329)	12,089
Deferred costs	1,746	(1,974)	794
Income taxes receivable	—	(18,795)	40,319
Other assets	(520)	—	(8)
Other liabilities	6,774	(3,180)	1,455
Accounts payable and accrued expenses	(12,615)	12,602	3,472
Income taxes payable	439	(1,590)	—
Accrued restructuring reserve	1,448	(657)	(3,989)
Deferred revenue	1,705	994	7,549
Net cash provided by operating activities	144,777	226,413	303,567
Investing activities:			
Purchases of property and equipment	(38,077)	(45,785)	(53,094)
Sales and maturities of investments	37,725	116,128	10,316
Purchases of investments	(50,762)	(81,239)	(1,494)
Businesses acquired, net of cash acquired	(21,658)	(695,547)	706
Net cash used in investing activities	(72,772)	(706,443)	(43,566)
Financing activities:			
Increase in restricted cash	(44)	(8,852)	7,708
Proceeds from note payable	—	591,000	—
Principal repayments on notes payable	(987)	(1,500)	(6,000)
Principal repayments on capital lease obligations	(12,208)	(7,171)	(3,494)
Debt issuance costs	—	(20,418)	—
Proceeds from exercise of common stock options	7,766	39,278	59,056
Excess tax benefits from stock-based compensation	1,613	4,541	9,041
Repurchase of restricted stock awards	(691)	(1,641)	(10,212)
Repurchase of common stock	(40,400)	(324,301)	(98,040)
Net cash (used in) provided by financing activities	(44,951)	270,936	(41,941)
Effect of foreign exchange rates on cash and cash equivalents	(65)	(239)	(42)
Net increase (decrease) in cash and cash equivalents	26,989	(209,333)	218,018
Cash and cash equivalents at beginning of year	304,581	331,570	122,237
Cash and cash equivalents at end of year	\$331,570	\$ 122,237	\$340,255
Supplemental cash flow information:			
Cash paid for interest	\$ 1,247	\$ 762	\$ 31,209
Cash paid for income taxes	\$ 72,726	\$ 40,715	\$ 50,229
Non-cash investing activities:			
Property and equipment acquired under capital leases	\$ 1,414	\$ 1,141	\$ 1,057
Accounts payable incurred to purchase property and equipment	\$ 1,104	\$ 2,733	\$ 5,759
Equity awards assumed in TARGUSinfo acquisition	\$ —	\$ 677	\$ —

See accompanying notes.

NEUSTAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND ORGANIZATION

NeuStar, Inc. (the Company or Neustar) is a trusted provider of real-time information and analysis using proprietary and hard to replicate data sets. The Company's customers use its services for commercial insights that help them promote and protect their businesses. The Company combines proprietary, third party and customer data sets to develop unique algorithms, models, point solutions and complete work flow solutions. Among other things, chief marketing, security, information and operating officers use these real-time insights to identify who or what is at the other end of a transaction, the geographic-context of a transaction and the most appropriate response. The Company provides its services in a trusted and neutral manner. The Company's customers access its databases through standard connections, which the Company believes is the most efficient and cost effective way to exchange operationally essential data in a secured environment that does not favor any particular customer or technology. Today the Company primarily serves customers in the Internet, communications, information services, financial services, retail, and media and advertising verticals.

The Company was founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. The Company provides the authoritative solution that the communications industry relies upon to meet this mandate. Since then, the Company has grown to offer a broad range of innovative services, including database services (telephone number databases, domain names, short-codes and fixed IP addresses), analytics platforms used for Internet security services, caller identification services, web performance monitoring services and real-time information and analytics services.

The Company provides the North American communications industry with real-time information that enables the dynamic routing of virtually all telephone calls and text messages among competing carriers in the United States and Canada. The Company's internet and eCommerce customers use its broad array of domain name systems (DNS) solutions to resolve internet queries in a timely manner and to protect their businesses from malicious attacks. The Company also provides a broad suite of solutions that allows its customers to generate marketing leads, offer more relevant services and improve client conversion rates.

The Company categorizes its services into three reportable segments:

- *Carrier Services.* The Company's carrier services include numbering services, order management services and IP services. Through its set of unique databases and system infrastructure in geographically dispersed data centers, the Company manages the increasing complexity in the communications industry and ensures the seamless connection of its carrier customers' numerous networks, while also enhancing the capabilities and performance of their infrastructure. The Company operates the authoritative databases that manage virtually all telephone area codes and numbers, and enables the dynamic routing of calls and text messages among numerous competing carriers in the United States and Canada. All carriers that offer telecommunications services to the public at large in the United States and Canada must access a copy of the Company's unique database to properly route their customers' calls and text messages. The Company also facilitates order management and work-flow processing among carriers, and allows operators to manage and optimize the addressing and routing of IP communications.
- *Enterprise Services.* The Company's enterprise services include Internet infrastructure services (IIS) and registry services. Through the Company's global directory platform, the Company provides a suite of DNS services to its enterprise customers. The Company manages a collection of directories that maintain addresses in order to direct, prioritize and manage Internet traffic, and to find and resolve Internet queries and top-level domains. The Company is the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and connectivity. In addition, enterprise customers rely on the Company's

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services to monitor and load-test websites to help identify issues and optimize performance. The Company also provides fixed IP geolocation services that help enterprises identify the location of their online consumers for a variety of purposes, including fraud prevention and marketing. Additionally, the Company provides directory services for the 5- and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry. The Company also operates the user authentication and rights management system, which supports the UltraViolet™ digital content locker that consumers can use to access to their entertainment content.

- *Information Services.* The Company's information services include on-demand solutions that help carriers and enterprises identify, verify, evaluate and locate customers and prospective customers. The Company's authoritative databases and solutions enable its clients to return the caller name associated with the calling phone number and to make informed decisions in real time about consumer-initiated interactions on the Internet, over the telephone and at the point of sale, by correlating consumer identifier information with attributes such as demographics, buying behavior surveys and location. This allows the Company's customers to offer consumers more relevant services and products, and leads to higher client conversion rates. Using the Company's proprietary databases, the Company's online display advertising solution allows marketers to display, in real time, advertisements that will be most relevant to online consumers without the need for online behavioral tracking.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany transactions and accounts have been eliminated in consolidation. The Company consolidates investments where it has a controlling financial interest. The usual condition for controlling financial interest is ownership of a majority of the voting interest and, therefore, as a general rule, ownership, directly or indirectly, of more than 50% of the outstanding voting shares is a condition indicating consolidation. The Company does not have any variable interest entities or investments accounted for under the equity method of accounting.

Discontinued Operations

A business is classified as discontinued operations when (1) the operations and cash flows of the business can be clearly distinguished and have been or will be eliminated from the Company's ongoing operations; (2) the business has either been disposed of or is classified as held for sale; and (3) the Company will not have any significant continuing involvement in the operations of the business after the disposal transaction. The results of discontinued operations (as well as the gain or loss on the disposal) are aggregated and separately presented in the Company's consolidated statement of operations, net of income taxes.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets; the identification and quantification of income tax liabilities due to uncertain tax positions; restructuring liabilities; valuation of investments; recoverability of intangible assets, other long-lived assets and goodwill; the determination of the allowance for

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doubtful accounts; and the classification of note payable. The Company bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic Financial Instruments requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. Due to their short-term nature, the carrying amounts reported in the accompanying consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses. The Company determines the fair value of its investments using third-party pricing sources, which primarily use a consensus price or weighted average price for the fair value assessment. The consensus price is determined by using matrix prices from a variety of industry standard pricing services, data providers, large financial institutions and other third party sources and utilizing those matrix prices as inputs into a distribution-curve-based algorithm to determine the estimated market value. Matrix prices are based on quoted prices for securities with similar terms (i.e., coupon rate, maturity, credit rating) (see Note 5). The Company believes the carrying value of its notes receivable approximates fair value as the interest rate approximates a market rate. The Company believes the carrying value of its long-term debt approximates the fair value of the debt as the terms and interest rates approximate market rates.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	December 31,			
	2011		2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$122,237	\$122,237	\$340,255	\$340,255
Restricted cash (current assets)	\$ 10,251	\$ 10,251	\$ 2,543	\$ 2,543
Short-term investments	\$ 10,545	\$ 10,545	\$ 3,666	\$ 3,666
Notes receivable (including current portion)	\$ 6,534	\$ 6,534	\$ 3,748	\$ 3,748
Marketable securities (other assets, long-term)	\$ 4,008	\$ 4,008	\$ 4,458	\$ 4,458
Long-term investments	\$ 2,506	\$ 2,506	\$ —	\$ —
Deferred compensation (other liabilities long-term)	\$ 4,028	\$ 4,028	\$ 3,874	\$ 3,874
Note payable (including current portion)	\$589,665	\$589,665	\$584,813	\$584,813

Cash and Cash Equivalents

The Company considers all highly liquid investments, which are investments that are readily convertible into cash and have original maturities of three months or less at the time of purchase, to be cash equivalents.

Restricted Cash

As of December 31, 2011 and 2012, restricted cash was \$10.3 million and \$2.5 million, respectively. As of December 31, 2011, cash of \$9.2 million was restricted as collateral for the Company's outstanding letters of credit. As of December 31, 2011 and December 31, 2012, cash of \$1.1 million and \$2.5 million, respectively, was restricted for deposits on leased facilities.

Concentrations of Credit Risk

Financial instruments that are potentially subject to a concentration of credit risk consist principally of cash, cash equivalents, investments, and accounts receivable. The Company's cash management and investment policies are in place to restrict placement of these instruments with only financial institutions evaluated as highly creditworthy.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

With respect to accounts receivable, the Company performs ongoing evaluations of its customers, generally granting uncollateralized credit terms to its customers, and maintains an allowance for doubtful accounts based on historical experience and management's expectations of future losses. Customers under the Company's contracts with North American Portability Management LLC (NAPM) are charged a Revenue Recovery Collection (RRC) fee (see "Accounts Receivable, Revenue Recovery Collections and Allowance for Doubtful Accounts" below).

Investments

The Company's investments classified as available-for-sale are carried at estimated fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other (expense) income. The cost at time of sale of available-for-sale investments is based upon the specific identification method. Interest and dividends on these securities is included in interest and other income.

The Company periodically evaluates whether any declines in the fair value of its investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; the Company's intent to sell an impaired security; and the probability that the Company will be required to sell the security before the market value recovers. If an investment which the Company does not intend to sell prior to recovery declines in value below its amortized cost basis and it is not more likely than not that the Company will be required to sell the related security before the recovery of its amortized cost basis, the Company recognizes the difference between the present value of the cash flows expected to be collected and the amortized cost basis, or credit loss, as an other-than-temporary charge in interest and other expense. The difference between the estimated fair value and the security's amortized cost basis at the measurement date related to all other factors is reported as a separate component of accumulated other comprehensive loss.

The Company's investments classified as trading are carried at estimated fair value with unrealized gains and losses reported in other (expense) income. During 2010, the Company classified its auction rate securities as trading pursuant to the Investments – Debt and Equity Securities Topic of the FASB ASC, with changes in the fair value of these securities recorded in earnings (see Note 4). Interest and dividends on these securities are included in interest and other income.

Accounts Receivable, Revenue Recovery Collections and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount and do not bear interest. In accordance with the Company's contracts with NAPM, the Company bills a RRC fee to offset uncollectible receivables from any individual customer. The RRC fee is based on a percentage of monthly billings. During 2009, the RRC fee was 0.75%. On July 1, 2010, the RRC fee was reduced to 0.65% and remained at that level through December 31, 2012. The RRC fees are recorded as an accrued expense when collected. If the RRC fee is insufficient, the amounts can be recovered from the customers. Any accrued RRC fees in excess of uncollectible receivables are paid back to the customers annually on a pro rata basis. RRC fees of \$2.4 million and \$2.6 million are included in accrued expenses as of December 31, 2011 and 2012, respectively. All other receivables related to services not covered by the RRC fees are evaluated and, if deemed not collectible, are reserved. The Company recorded an allowance for doubtful accounts of \$1.9 million and \$2.2 million as of December 31, 2011 and 2012, respectively. Bad debt expense amounted to \$2.6 million, \$2.6 million and \$4.1 million for the years ended December 31, 2010, 2011 and 2012, respectively.

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Deferred Financing Costs

The Company amortizes deferred financing costs using the effective-interest method and records such amortization as interest expense. Amortization of debt discount and annual commitment fees for unused portions of available borrowings are also recorded as interest expense. Direct and incremental costs related to the issuance of debt are capitalized as deferred financing costs and are reported in other assets on the Company's consolidated balance sheets.

Property and Equipment

Property and equipment, including leasehold improvements and assets acquired through capital leases, are recorded at cost, net of accumulated depreciation and amortization. Depreciation and amortization of property and equipment are determined using the straight-line method over the estimated useful lives of the assets, as follows:

Computer hardware	3 – 5 years
Equipment	5 years
Furniture and fixtures	5 – 7 years
Leasehold improvements	Lesser of related lease term or useful life

Amortization expense of assets acquired through capital leases is included in depreciation and amortization expense in the consolidated statements of operations. Replacements and major improvements are capitalized; maintenance and repairs are charged to expense as incurred. Impairments of long-lived assets are determined in accordance with the Property, Plant and Equipment Topic of the FASB ASC. In the fourth quarter of 2010, the Company recorded an impairment charge of \$7.9 million related to property and equipment, including capitalized technology, used by its Converged Messaging asset group (see "Impairment of Long-Lived Assets" below).

The Company capitalizes software development and acquisition costs in accordance with the Intangibles — Goodwill and Other, Internal-Use Software Topic of the FASB ASC, which requires the capitalization of costs incurred in connection with developing or obtaining software for internal use. Costs incurred to develop the internal-use software are capitalized, while costs incurred for planning the project and for post-implementation training and maintenance are expensed as incurred. The capitalized costs of purchased technology and software development are amortized using the straight-line method over an estimated useful life of three to five years. During the years ended December 31, 2011 and 2012, the Company capitalized costs related to internal use software of \$28.6 million and \$30.3 million, respectively. Amortization expense related to internal use software for the years ended December 31, 2010, 2011 and 2012 was \$15.2 million, \$17.3 million and \$24.1 million, respectively, and is included in depreciation and amortization expense in the consolidated statements of operations.

Goodwill

Goodwill represents the excess of the purchase price over the fair value of assets acquired, as well as other identifiable intangible assets. In accordance with the Intangibles — Goodwill and Other Topic of the FASB ASC, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment at least annually and upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. For purposes of the Company's annual impairment test completed on October 1, 2010, the Company identified and assigned goodwill to three reporting units, Carrier Services, Internet Infrastructure Services and Registry Services. For purposes of the Company's annual impairment test

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completed on October 1, 2011, the Company identified and assigned goodwill to two reporting units, Carrier Services and Enterprise Services. The Company's third reporting unit, Information Services, was established as a result of the acquisition of Targus Information Corporation (TARGUSinfo) on November 8, 2011, and was not included in the Company's annual impairment test completed on October 1, 2011. For purposes of the Company's annual impairment test completed on October 1, 2012, the Company identified and assigned goodwill to three reporting units, Carrier Services, Enterprise Services and Information Services.

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both a discounted cash flow method and a market approach. To assist in the process of determining if a goodwill impairment exists, the Company performs internal valuation analyses and considers other market information that is publicly available, and the Company may obtain valuations from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, the Company performs a second step to measure the amount of the impairment, if any. The second step is to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill, using a theoretical purchase price allocation. If the carrying value of goodwill exceeds the implied fair value, an impairment has occurred and the Company is required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. There were no goodwill impairment charges recognized during the years ended December 31, 2010, 2011 and 2012.

Segment Reporting

Operating segments are components of an enterprise about which discrete financial information is available that is evaluated regularly by the chief operating decision maker (CODM) in deciding how to allocate resources and in assessing performance. As of December 31, 2012, the Company's CODM evaluates performance and allocates resources based on multiple factors, including segment contribution for the following service categories: Carrier Services, Enterprise Services and Information Services. The Company's operating segments are the same as its reportable segments.

Identifiable Intangible Assets

Identifiable intangible assets are amortized over their respective estimated useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used and are periodically reviewed for impairment. In the fourth quarter of 2010, the Company recorded an intangible asset impairment charge of \$0.6 million related to its Converged Messaging asset group (see "Impairment of Long-Lived Assets" below). There were no intangible asset impairment charges recognized during the years ended December 31, 2011 and 2012.

The Company's identifiable intangible assets are amortized as follows:

	<u>Years</u>	<u>Method</u>
Acquired technologies	3 – 5	Straight-line
Customer lists and relationships	3 – 10	Various
Trade names and trademarks	3	Straight-line

Amortization expense related to identifiable intangible assets is included in depreciation and amortization expense in the consolidated statements of operations.

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Impairment of Long-Lived Assets

In accordance with Property, Plant and Equipment Topic of the FASB ASC, the Company reviews long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The Company measures recoverability of assets to be held and used by comparing the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. Recoverability measurement and estimating undiscounted cash flows is performed at the lowest possible level for which there are identifiable cash flows. If the carrying amount of the assets exceeds the future undiscounted cash flows expected to be generated by those assets, such assets fail the recoverability test and an impairment charge would be recognized, measured as the amount by which the carrying amount of the assets exceeds the fair value. Assets to be disposed of are recorded at the lower of the carrying amount or fair value less costs to sell.

In the first quarter of 2010, the Company realigned its organizational structure, and its NGM business was included with other IP-related services in the Company's Carrier Services operating segment. The services, technology and customer base of the NGM business was renamed Converged Messaging Services while the sales and marketing functions were transitioned to the broader Carrier Services operating segment. In the fourth quarter of 2010, the Company decided to exit the Converged Messaging Services business. The Company believes that its decision to exit this business was an indicator of impairment for long-lived assets in its Converged Messaging Services asset group. As a result, in the fourth quarter of 2010, the Company performed a recoverability test and determined that the future undiscounted cash flows of the asset group was less than the carrying value. The Company recorded an \$8.5 million charge for impairment of long-lived assets, the largest component of which was capitalized technology. In determining fair value, the Company utilized estimates from external advisors and valuation models that involved assumptions about replacement cost, obsolescence factors, future cash flows, discount rates and, as appropriate, review of market comparables. During the second quarter of 2011, the Company ceased operations of its Converged Messaging Services business and all corresponding prior period results of this business presented in the Company's consolidated statements of operations have been reclassified to reflect the operations of the Converged Messaging Services business as discontinued operations (see Note 3).

Revenue Recognition

The Company provides essential technology and directory services to customers pursuant to various private commercial and government contracts. The Company's revenue recognition policies are in accordance with the Revenue Recognition Topic of the FASB ASC.

Significant Contracts

As part of its carrier services, the Company provides number portability administration center services (NPAC Services), which include wireline and wireless number portability, implementation of the allocation of pooled blocks of telephone numbers and network management services in the United States pursuant to seven contracts with NAPM, an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts are determined by an annual fixed-fee pricing model under which the annual fixed fee (Base Fee) was set at \$362.1 million, \$385.6 million and \$410.7 million in 2010, 2011 and 2012, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for fixed credits to customers of \$25.0 million in 2010 and \$5.0 million in 2011, which were applied to reduce the Base Fee for the applicable year. Customers under these contracts could have earned additional credits of up to \$15.0 million annually in each of 2010 and 2011 if the customers reached specific levels of aggregate telephone number inventories and adopted and implemented

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certain IP fields and functionality. In the event that the volume of transactions in a given year is above or below the contractually established volume range for that year, the Base Fee may be adjusted up or down, respectively, with any such adjustment being applied against invoices in the following year. To the extent any available additional credits expire unused at the end of a year, they will be recognized in revenue at that time. The Company determines the fixed and determinable fee under these contracts on an annual basis at the beginning of each year and recognizes this fee in its Carrier Services operating segment on a straight-line basis over twelve months.

For 2010, the Company concluded that the fixed and determinable fee equaled \$322.1 million, which represented the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. For 2011, the Company concluded that the fixed and determinable fee equaled \$365.6 million, which represents the Base Fee of \$385.6 million, reduced by the \$5.0 million fixed credit and \$15.0 million of additional credits. During 2010 and 2011, the Company determined that its carrier customers have earned all of the additional credits of \$15.0 million attributable to the adoption and implementation of the requisite IP fields and functionality and the achievement of specific levels of aggregate telephone number inventories. For 2012, the Company concluded that the fixed and determinable fee equaled \$410.7 million, which represents the Base Fee.

The total amount of revenue derived under the Company's contracts with NAPM, comprised of NPAC Services, connection service fees related to the Company's NPAC Services and system enhancements, was approximately \$337.1 million, \$374.4 million and \$418.2 million for the years ended December 31, 2010, 2011 and 2012, respectively.

Fees under the Company's contracts with NAPM are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers, as determined by the Federal Communications Commission. The Company also bills an RRC fee equal to a percentage of monthly billings to its customers, which is available to the Company if any customer under the contracts to provide NPAC services fails to pay its allocable share of total transactions charges.

Carrier Services

Under its seven contracts with NAPM, the Company provides NPAC Services. As discussed above under the heading "Revenue Recognition — Significant Contracts," the Company determines the fixed and determinable fee on an annual basis and recognizes such fee on a straight-line basis over twelve months.

The Company provides NPAC Services in Canada under its long-term contract with the Canadian LNP Consortium Inc. The Company recognizes revenue on a per-transaction fee basis as the services are performed.

The Company generates revenue from its telephone number administration services under two government contracts: North American Numbering Plan Administrator (NANPA) and National Pooling Administrator (NPA). Under its NANPA contract, the Company earns a fixed annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. Under its NPA contract, the Company earns a fixed fee associated with administration of the pooling system. The Company recognizes revenue for this contract on a straight-line basis over the term of the contract. In the event the Company estimates losses on these fixed price contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

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The Company generates revenue from connection fees and system enhancements provided under its contracts with NAPM. The Company recognizes connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is reimbursed for costs incurred plus a fixed fee, and revenue is recognized based on costs incurred plus a pro rata amount of the fee.

The Company provides hosted Order Management Services, consisting of customer set-up and implementation followed by transaction processing, under contracts with terms ranging from one to three years. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees for these services are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per-transaction fees are recognized as the transactions are processed.

The Company generates revenue from its licensed Order Management Services under contracts with terms ranging from three months to two years. The Company generates revenue under these contracts for software licenses, implementation and customization services and post-contract support services (PCS). Under these contracts, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, collectability is probable and, if applicable, when vendor-specific objective evidence (VSOE) of fair value exists to allocate the arrangement fee to the undelivered elements of a multiple element arrangement. Revenue is allocated to delivered elements of an arrangement using the residual method. Under the residual method, revenue is allocated to the undelivered elements using VSOE of fair value with the remaining contract fee allocated to the delivered elements and recognized as revenue when all other revenue recognition criteria have been met. For software contracts that include customization services that are essential to the functionality of the delivered software, the software license and implementation and customization revenue is recognized under the contract method of accounting using the percentage-of-completion method. The Company estimates the percentage-of-completion for each contract based on the ratio of direct labor hours incurred to total estimated direct labor hours required under such contract and recognizes an amount of revenue equal to the percentage-of-completion multiplied by the contract amount allocated to the software license and implementation and customization services fees. The contract amount allocated to these delivered elements is determined under the residual method approach. The Company determined the VSOE of PCS under the bell-shape curve approach and determined that a substantial majority of its actual PCS renewals are within a narrow range of the median pricing. For arrangements with bundled PCS where there is no stated contractual PCS rate or where the rate is less than the established range of VSOE, the Company utilizes the low end of the range for VSOE as the fair value of PCS. PCS revenue is recognized on a straight-line basis over the service term of the contract.

Enterprise Services

The Company generates revenue from the management of internal and external DNS services. The Company's revenue from these services consists of customer set-up fees, monthly recurring fees and per-transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company's contracts to provide DNS services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month, the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided.

The Company generates revenue related to its Internet domain name registry services under contracts with terms generally between one and ten years. The Company recognizes revenue on a straight-line basis over the term of the related customer contracts.

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The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the related customer contracts.

Information Services

The Company generates revenue from a broad portfolio of real-time information and analytics services. The Company recognizes revenue when persuasive evidence of an agreement exists, the terms are fixed or determinable, services are performed, and collection is reasonably assured. Certain contracts provide for a guaranteed monthly minimum fee supplemented by fees for transactions above specified minimum amounts. The minimum fee is recognized monthly, and the transaction fees in excess of the monthly minimums are recognized as the services are performed. The Company also receives annual technology fees from certain customers in exchange for access to intellectual property, standard technical support, emergency 24-hour support, and system upgrades on a when-and-if-available basis. These services are not considered a separate deliverable. As a result, technology fees are deferred and recognized on a straight-line basis over the service period, which is usually twelve months.

Revenue derived from the online delivery of data for direct marketing purposes is recorded upon delivery of such data to the customer. Revenue associated with engagements requiring periodic updates of data over the course of the service period, where cash is received or collectible in advance, are recorded as deferred revenues, and recognized on a straight-line basis over the service period, which is usually twelve months.

Service Level Standards

Some of the Company's private commercial contracts require the Company to meet service level standards and impose corresponding penalties on the Company if the Company fails to meet those standards. The Company records a provision for these performance-related penalties in the period in which it becomes aware that it has failed to meet required service levels, triggering the requirement to pay a penalty, which results in a corresponding reduction to revenue.

Cost of Revenue and Deferred Costs

Cost of revenue includes all direct materials costs, direct labor costs, and indirect costs related to the generation of revenue such as indirect labor, outsourced services, materials and supplies, payment processing fees, and general facilities cost. The Company's primary cost of revenue is personnel costs associated with service implementation, product maintenance, customer deployment and customer care, including salaries, stock-based compensation and other personnel-related expense. In addition, cost of revenue includes costs relating to developing modifications and enhancements of the Company's existing technology and services, as well as royalties paid related to U.S. Common Short Code services and registry gateway services. Cost of revenue also includes costs relating to the Company's information technology and systems department, including network costs, data center maintenance, database management, data processing costs and general facilities costs.

Deferred costs represent direct labor related to professional services incurred for the setup and implementation of contracts. These costs are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs also include royalties paid related to the Company's U.S. Common Short Code services, which are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs are classified as such on the consolidated balance sheets.

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Research and Development

The Company expenses its research and development costs as they are incurred. Research and development expense consists primarily of personnel costs, including salaries, stock-based compensation and other personnel-related expense, consulting fees, and the costs of facilities, computer and support services used in service and technology development.

Advertising

The Company expenses advertising costs as they are incurred. Advertising expense was approximately \$6.7 million, \$6.6 million and \$12.7 million for the years ended December 31, 2010, 2011 and 2012, respectively.

Stock-Based Compensation

The Company accounts for its stock-based compensation plans under the recognition and measurement provisions of the Compensation — Stock Compensation Topic of the FASB ASC. The Company estimates the value of stock-based awards on the date of grant using the Black-Scholes option-pricing model. For stock-based awards subject to graded vesting, the Company has utilized the “straight-line” method for allocating compensation cost by period.

The Company presents benefits of tax deductions in excess of the compensation cost recognized (excess tax benefits) as a financing cash inflow with a corresponding operating cash outflow. For the years ended December 31, 2010, 2011 and 2012, the Company included \$1.6 million, \$4.5 million and \$9.0 million, respectively, of excess tax benefits as a financing cash inflow with a corresponding operating cash outflow.

Basic and Diluted Net Income per Common Share

In accordance with the Earnings Per Share Topic of the FASB ASC, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities that should be included in the computation of earnings per share under the two-class method. The Company's restricted stock awards are considered to be participating securities because they contain non-forfeitable rights to cash dividends, if declared and paid. In lieu of presenting earnings per share pursuant to the two-class method, the Company has included shares of unvested restricted stock awards in the computation of basic net income per common share as the resulting earnings per share would be the same under both methods.

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares and participating securities outstanding during the period. Unvested restricted stock units and performance vested restricted stock units (PVRSU) are excluded from the computation of basic net income per common share because the underlying shares have not yet been earned by the stockholder and are not participating securities. Shares underlying stock options are also excluded because they are not considered outstanding shares. Diluted net income per common share assumes dilution and is computed based on the weighted-average number of common shares outstanding after consideration of the dilutive effect of stock options, unvested restricted stock units and PVRSU. The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. Dilutive securities with performance conditions are excluded from the computation until the performance conditions are met.

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Income Taxes

The Company accounts for income taxes in accordance with the Income Taxes Topic of the FASB ASC. Deferred tax assets and liabilities are determined based on temporary differences between the financial reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

The income tax provision includes U.S. federal, state, local and foreign income taxes and is based on pre-tax income or loss. In determining the annual effective income tax rate, the Company analyzes various factors, including the Company's annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes and the ability of the Company to use tax credits and net operating loss carryforwards.

The Company assesses uncertain tax positions in accordance with income tax accounting standards. Under these standards, income tax benefits should be recognized when, based on the technical merits of a tax position, the Company believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense.

American Taxpayer Relief Act of 2012

On January 2, 2013, President Barack Obama signed into law the "American Taxpayer Relief Act of 2012" (the Act). While Congress approved a retroactive extension of certain business tax provisions that expired at the end of 2011 and 2012, under U.S. GAAP, the financial accounting effects of the Act are to be reported in the first quarter of calendar year 2013, the quarter in which the legislation was signed into law by the President. The Company does not believe the Act will have a material effect on the Company's financial position, results of operations or cash flows.

Foreign Currency

Assets and liabilities of consolidated foreign subsidiaries, whose functional currency is the local currency, are translated to U.S. dollars at fiscal year-end exchange rates. Revenue and expense items are translated to U.S. dollars at the average rates of exchange prevailing during the fiscal year. The adjustment resulting from translating the financial statements of such foreign subsidiaries to U.S. dollars is reflected as a foreign currency translation adjustment and reported as a component of accumulated other comprehensive loss.

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains or losses, which are reflected within interest and other expense in the consolidated statements of operations.

Comprehensive Income

Comprehensive income is comprised of net earnings and other comprehensive income (loss), which includes certain changes in equity that are excluded from income. The Company includes unrealized holding gains and